IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 20

CORN PRODUCTS REFINING COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REHEARING

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To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner petitions for a rehearing pursuant to Rule 58 of the Rules of this Court. The decision of this Court was handed down on November 7, 1955.

Grounds for Rehearing

THIS COURT'S DECISION IN THE INSTANT CASE, AS EXPLAINED IN ITS OPINION

I. OVERLOOKS VITAL LEGISLATIVE HISTORY,

II. DOES NOT FOLLOW ITS OWN ESTABLISHED AND APPLICABLE RULES OF STATUTORY CONSTRUCTION,

III. STEMS FROM A MISREADING OF THE AUTHORITIES ON A VITAL POINT,

IV. WILL LEAD TO UNCERTAINTY AND MULTITUDINOUS LITIGATION.

A REHEARING SHOULD BE GRANTED IN THE INTERESTS OF JUSTICE AND GOOD TAX ADMINISTRATION.

Introduction

The instant case presents the question of whether certain purchases and sales of corn futures by Petitioner fall within the purview of Section 117 of the Internal Revenue Code. This Court has answered that question in the negative.

Petitioner believes that it can demonstrate that the decision in the instant case overlooks vital legislative history which clearly indicates a Congressional intention with respect to Section 117 completely at variance with that stated in the opinion.

Furthermore, Petitioner does not believe that this Court could have adverted to, or that Respondent desires, the uncertainty and multitudinous litigation that the scope of the opinion in the instant case will, it is believed, entail. In this connection Petitioner quotes two excerpts from the November 11, 1955 issue of a Research Institute of America bulletin (Appendix A contains the entire discussion of the subject):

"The Supreme Court's decision on hedging

transactions has shaken the established concept of capital gains and losses."

"Observation: The *Corn Products* decision is an invitation to litigation and a step toward uncertainty in the important area of capital gains. The Supreme Court's judicial modification of the statutory rules on capital gains and losses can only compound the difficulties of distinguishing between ordinary income and loss and capital gain and loss."

There is such widespread interest in the decision in the instant case and its effects will be so far reaching that Petitioner earnestly entreats this Court to re-examine its decision.

I

One of the main bases for this Court's decision seems to be that Petitioner's corn futures purchases and sales were an integral part of its business, designed to protect its manufacturing operations against a price increase in its principal raw material and to assure a ready supply of the same for future manufacturing requirements. As the opinion states (p. 4):

"Under these facts it is difficult to imagine a program more closely geared to a company's manufacturing enterprise or more important to its successful operation."

From the foregoing this Court reaches the conclusion that Petitioner's corn futures activities did not fall within the purview of Section 117 and consequently would not be given capital gain or loss treatment. The opinion is not clear just how this conclusion follows. Presumably the connecting link between premise and conclusion is to be found in another part of the opinion[1] where this Court says "Congress intended that profits and losses arising from the every day operation of a business be considered as ordinary income or loss rather than capital gain or loss", and, "The preferential treatment provided by Section 117 applies to transactions in property which are not the normal source of business income". (p. 6).

Petitioner has been unable to find anything that would support the validity of the above quotations with respect to the intent of Congress and the application of Section 117. The opinion offers no foundation or supporting material. It does state, though, in the course of amplifying the above quotations, that it was the intention of Congress in Section 117 to relieve a taxpayer from excessive tax burdens on gains, citing *Burnet* v. *Harmel*, 287 U. S. 103, and that since such relief was an exception from normal tax requirements, "*the definition of capital assets must be narrowly applied . . . to effectuate the basic Congressional purpose.*" (p. 6) (emphasis supplied).

[1] Which is concerned with a totally different point, the hedging exception.

Petitioner submits, with the greatest deference, that this Court has overlooked vital legislative history that quite definitely indicates that Congress intended that the definition of capital assets, as it existed at the time pertinent to the instant case, be given a broad, if not the broadest, application, and not a narrow application. If this be true, then, the basic Congressional purpose must be different from the one which a narrow application of the capital assets definition would effectuate, and cannot be the one set forth in the above quotations with respect to the intent of Congress and the application of Section 117.

Burnet v. *Harmel*, cited with approval by this Court as above set forth, was decided under the 1924 Revenue Act. At that time, Section 206, the predecessor of Section 117, was concerned with the problem of relief for taxpayers who had gains from the sale of certain assets. But Section 117 as it was adopted in 1934 (and as it existed, with certain minor changes, in the 1939 Internal Revenue Code which is applicable to the instant case) was concerned with a totally different problem.

The totally different problem was that men of wealth were offsetting their income with losses[2] on sales of their property. This they were assisted in doing be-

[2] It will be remembered that the early thirties were depression years and losses on sales of property were the order of the day.

cause of, among other things, the narrowness of the definition of capital assets in Section 206.

This Court appears to have overlooked the difference between the gain problem that Section 206 was primarily intended to cope with and the loss problem that Section 117 was primarily intended to cope with. Indeed, this Court's preoccupation with the gains aspect of the Section can be seen from its reference to the "preferential treatment provided by Section 117" (p. 6) as supporting its position.

In fact, there are two aspects to Section 117, one involving gains (where preferential treatment is provided in limited situations) and the other involving loss (where in all situations rigorous treatment, the antithesis of preferential, is provided). But it was with the loss aspect that Congress was primarily and seriously concerned[3] when it redefined capital assets in Section 117(b)[4] in 1934 and added Section 117(d). It wanted a broad definition of the term. By such a definition it would be better able to reach the evil, i. e., the deductibility of losses on sales of assets, which it sought to minimize.

The strict limitation of losses on the sale of assets is the key to the true Congressional intent for the instant case. A narrow interpretation of the term

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[3] See Seidman's Legislative History of Federal Income Tax Laws, 1938-1861, pp. 360-369

[4] The predecessor of Section 117(a) of the 1939 Internal Revenue Code.

capital assets does not serve this intent while a broad interpretation does.

Thus we find the House Ways and Means Committee (73rd Cong., 2nd Sess., H. R. 704, p. 31) stating:

> "Subsection (b) defines capital assets. It will be noted that the definition includes all property except as specifically excluded."

This language was adopted in Reg. 86 of the Revenue Act of 1934, Reg. 94 of the Revenue Act of 1936, Reg. 101 of the Revenue Act of 1938 and Reg. 103 of the Internal Revenue Code of 1939.

Petitioner respectfully submits that this Court's attention has been misdirected from the true Congressional intent. The foregoing summary statement of the legislative history of the Section and the evil sought to be remedied therein clearly indicates anything but a narrow interpretation of the definition of capital assets in Section 117(a). It clearly indicates the Congressional preoccupation with losses on sales of property. It reveals an intent and desire that these be limited severely and not be deductible except where (and to the extent) definitely and specifically authorized. It clearly indicates that Congress intended exactly what it said (see Point II). It clearly indicates that the decision of this Court will, by narrow interpretation of capital and consequent easing of the loss limitation frustrate, rather than effectuate, the basic purpose of Congress.

II

It is a cardinal rule of statutory construction, enunciated by this Court on countless occasions, that when the language of a statute is clear and unambiguous, Courts are bound to look for the intention of Congress in the words of the statute itself. To state the rule in another way: Congress intended what it unequivocally said and if the language employed is explicit it affords conclusive evidence of the Congressional intent. A corollary to this rule is that when the words of a statute have a plain and obvious meaning, such meaning cannot be extended or restricted by conjecture or under the guise or pretext of interpretation. This rule and corollary are, it is submitted, applicable in the instant case, and indicate with almost mathematical precision that Petitioner's corn futures transactions should be given capital treatment.

Congress set forth its intent in respect of capital gains and losses, as far as the facts of the instant case are concerned, in Section 117(a). There is no question but that the language used in the Section is clear and unambiguous. At no place has this Court said it was not. In this language Congress picked its way meticulously through all classes of sales. It designated some (all except those specifically excluded) for capital treatment and others (those specifically excluded) for non-capital treatment. The language, given its normal and natural meaning, is

clear that Petitioner's corn futures activities were such as to require capital treatment.[5]

There are no words in Section 117, that given their normal meaning, say that all sales of assets that are an integral part of a taxpayer's business are excluded from capital gain and loss treatment, as this Court concludes. The Section is explicit to the contrary. It almost seems as if Congress anticipated the point. It provided for the inclusion of some sales and the exclusion of others. Either class of sales, whether included or excluded, could involve the sale of property. This might, or might not (and it was immaterial which) be "connected with a trade or business", as an integral part thereof or otherwise.

A further rule of statutory construction, which this Court ignores in its decision, is that where a statute sets up a general rule and enumerates specific exceptions, further exceptions by way of mere implication are not permissible.[6] Section 117(a) sets up a general definition of capital assets. From this general definition specific exceptions are carved out. The

[5] The opinion states (p. 6) that "Petitioner's corn futures do not come within the literal language of the exclusions" in Section 117(a). This, of course, is tantamount to saying that Petitioner's corn futures come literally within the definition of capital assets in Section 117(a).

[6] *Richfield Oil Corporation* v. *State Board*, 329 U. S. 69 (1946); *Moore Ice Cream Company* v. *Rose*, 289 U. S. 373 (1933); *Cunard S. S. Co.* v. *Mellon*, 262 U. S. 100 (1923); *Addison* v. *Holly Hill Co.*, 322 U. S. 607 (1944); *Brooks* v. *St. Louis-San Francisco Ry. Co.*, 180 F. 2d 185 (8th Cir. 1950).

foregoing rule of statutory construction would proscribe further exceptions by mere implication.

The plain language of the statute, which under the applicable rules of statutory construction should control, will not, it is submitted with the greatest deference, support this Court's statements (1) that Congress intended that gains and losses arising from the every day operation of a business be ordinary income and losses and (2) that the so-called preferential treatment provided by Section 117 is restricted to transactions which are not the normal source of business income. It is difficult to see how Congress could have said more clearly in its language that neither statement was true. It is easy to see how Congress could have clearly said that which would have made them true. This Court's statements with respect to intent of Congress and the application of Section 117 are at best but rough approximations or oversimplified generalizations of the meticulous particularizations of Section 117. However, Congress decided on minute and specific instructions and not on general directions. A reading of the provisions of Section 117 as a whole should bring conviction on this score.

III

One of the main bases for this Court's decision is that hedging is an exception to Section 117(a). The opinion states that hedging as an exception to Sec-

tion 117(a) was first voiced by the Treasury in G. C. M. 17322,[7] that the courts have followed the proposition, and that Congress has, by reenacting the Code on three different occasions in light of that background, given approval to it.

Let us, however, examine the precise proposition that the G. C. M. voiced—the precise proposition that was followed by the courts and approved by Congress.

The proposition was quite simple. It was that "true hedging" was an exception to Section 117(a). Not something roughly akin to hedging, but "true hedging". A reading of the G. C. M. makes this abundantly clear. The examples set forth in G. C. M. 17322 are all examples of "true hedging", i. e., where there is a balanced market position, where a profit is fixed or insured, not, as in the instant case, where only the risk of the price going one way is eliminated.

All the cases on the subject,[8] with the exception of the instant case, are to the same effect. Almost all of them use the words "true hedging", and all of them quite clearly mean that.

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[7] XV-2 Cum. Bul. 151.

[8] *Ben Grote*, 41 B. T. A. 247 (1940); *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F. (2d) 772 (5th Cir. 1941), cert. denied, 314 U. S. 683 (1941); *Kenneth S. Battelle*, 47 B. T. A. 117 (1942); *Tennessee Egg Co.*, 47 B. T. A. 558 (1942); *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. (2d) 33 (6th Cir. 1945), affirming T. C. Memo Op. (Dec. 28, 1943); *Estate of Dorothy Makransky*, 5 T. C. 397 (1945), aff. 154 F. (2d) 59 (3rd Cir. 1946); *Stewart Silk Corp.*, 9 T. C. 174 (1947); *Fulton Bag & Cotton Mills*, 22 T. C. 1044 (1954).

In *Makransky v. Commissioner*, 5 T. C. 397 (1945), aff'd (3rd Cir. 1946) 154 F. (2d) 59, on which Petitioner relies,[9] the taxpayer there had the same sort of partial insurance that Petitioner in the instant case had. Since, however, the taxpayer in the *Makransky* case did not have a "true hedge", it was denied a fully deductible loss. It was told that it had a capital loss by the Commissioner of Internal Revenue and the Courts, whose consistency in these cases has been noted by this Court in its opinion (p. 7).

It was the "true hedging" concept, no other, that Congress approved. This can be seen from this Court's quote in its opinion (p. 7, footnote 9) from H. R. Report No. 1337, 83rd Cong., 2d Sess., p. A278; S. Rep. No. 1622, 83rd Cong., 2d Sess., p. 437, as follows:

> "Under existing law *bona fide* hedging transactions do not result in capital gains or losses. This result is based upon case law and regulations." (Emphasis Supplied).

In view of the fact that the "case law and regulations"[10] on which the quote is based both posit the criterion of "true hedge", it is clear that "true hedging" was intended. No other meaning squares with the "case law and the regulations".

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[9] This was a basic case on which the Writ of Certiorari in the instant case was granted. This Court cites this case in its opinion, but never discusses it.

[10] In point of fact G. C. M. 17322 never was promulgated into Regulation.

This Court has overlooked the fact that for the hedging exception to Section 117(a) a "true hedge" is requisite. The requisite was set up by the Commissioner of Internal Revenue, the Courts and Congress, the authorities on which this Court's conclusion is based that hedging is an exception to Section 117(a).

Although this Court doesn't seem to have squarely passed on the question of whether or not Petitioner had a "true hedge", such indication as there is on the point in the opinion seems quite clearly to be that Petitioner did not have a "true hedge" (p. 5).[11] If Petitioner did not have a "true hedge", Section 117 is operative and Petitioner's corn futures transactions give rise to capital gains and losses.

As a matter of fact, Petitioner did not have a "true hedge". For a complete discussion of this point, see the initial brief of Petitioner (Brief, pp. 23-28).

IV

By far the most devastating effect of the decision in the instant case is that it has opened a veritable Pandora's Box of uncertainties.[12] Confusion and multitudinous litigation will inevitably result, and neither is desirable.

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[11] The fact found and stated by both The Tax Court and the Circuit Court of Appeals was that Petitioner did not have a "true hedge".

[12] *Research Institute of America*, 1955 Edition: N. F. 7 November 11, 1955, p. 3. "The decision goes far beyond a mere settlement of the hedge situation. It puts the stamp of approval on a new theory of capital assets which may create substantial uncertainty in the area of capital gains and losses.

From its opinion, it is apparent that the criteria that this Court has adopted for determining whether sales of assets produce capital gains and losses or ordinary income and losses are the following:

(1) If the profits and losses (from the sales of assets) arise from the every day operation of a business, they are to be considered as ordinary income and losses.

(2) If the profits and losses (from the sales of assets) arise from transactions which are not the normal source of business' income, they are capital gains and losses.

(3) If the profits and losses (from the sales of assets) arise from transactions that are an integral part of a business or are geared to a company's business or are important for its successful operation, the are ordinary income and losses.

(4) If the profits and losses (from the sales of assets) arise from transactions that are not an integral part of a business, or are not geared to a company's business, or are not important for its successful operations, they are capital gains and losses.

These criteria are a far cry from Section 117 and its definition of capital assets in subsection 117(a). The uncertain, indeterminate, and disputable limits of such criteria are readily manifest. The possibilities of litigation are, as a consequence, limitless.

Consider the case of a manufacturing company. It needs large amounts of working capital from time to time. It can keep its working capital in cash, but more than likely, pending actual need for it, it will keep a good part of it in bonds or in stocks so that it will not be idle and unproductive. From time to time, as cash is needed, the stocks and bonds are sold. How should the gains or losses from these transactions be treated? Reference to Section 117, the Congressional enactment on the point, clearly indicates capital treatment.

But under the decision in the instant case, a real question will exist.

Working capital is vital to the success of the company and so is its investment. The latter is one of the normal, natural every day operations of the company (one of the Treasurer's or Finance Committee's regular duties is supervising investment). It is a regular and normal source of income. It is geared to the company's business and if it is an integral part of it. Will ordinary income or loss result under the decision in the instant case, and if there is a loss, will the limitation provisions of Section 117(d) apply? This can hardly be said to effectuate the basic purpose of Congress to limit severely losses on the sale of property unless the property sold could be fitted into certain specific classes (the exclusions in Section 117(a)).

In *Commissioner* v. *Baglin & Sewall Co.* (2nd Cir. 1955) — F. (2d) — affirming 20 T. C. 983 the tax-

payer, a contractor, was required under a contract to put up bonds as security for his proper performance. The taxpayer put up the bonds as required, performed the contract, and, on receiving back the bonds, sold them at a loss. He sought to deduct the loss in full as an ordinary loss. The Commissioner of Internal Revenue objected that the loss was a capital loss. Under Section 117 it seemed clear that the taxpayer's loss was a capital loss. The Circuit Court of Appeals, however, departing far from the words of Section 117, held that a fully deductible loss resulted. Mr. Justice Frank in a dissenting opinion made the following pertinent remarks:

> "The last clause of Section 117(a)(1) is illuminating: 'From "capital assets" it excepts "real property"—no other—if "used in the trade or business of the taxpayer.' My colleagues, in effect, treat that clause as if it read 'any property used in the trade or business of the taxpayer.' This, I think, an improper judicial amendment of the statute.
>
> * * * *
>
> "My conclusion here derives from no ardent desire to add to the government's revenues by invariably interpreting statutes adverse to taxpayers; see, e. g., my dissenting opinion in *Babcock & Wilson (sic) Co.* v. *Pedrick*, 217 Fed. (2d) 654 (C. A. 2). But I think that courts should not allow what they deem fairness to taxpayers to override one of the most sensible canons of

statutory construction, i. e., that, where a statute sets forth specific exceptions, further exceptions, by way of mere implication are not permissible. Moreover, to hold for the taxpayer here may well mean unfairness to other taxpayers who, having acquired securities in situations just like this, but having made a gain on the sale of the securities, seek to claim that their taxable profits are capital gains, not ordinary income."

If the decision in the instant case stands, the holding of the majority in the *Bagley* case has been approved. Section 117, as written, becomes to all practical purposes a dead letter. Purpose, motive and design of a sale become the important relevant factors, not the nature of the assets as Congress intended. Such certainty as the numerous cases decided under the Section had developed over the years is gone. The loss limitation dike erected by Congress has been breached. The Commissioner of Internal Revenue cannot possibly want this result, as witness his opposition in the *Bagley* case.

There are other recognizable areas of probable confusion and litigation. Good will and customer's lists are often acquired by a business. Stock in other corporations is often purchased to insure a source of supply or a new customer. All these assets can be purchased and sold as part of normal business operations. What treatment will now be afforded on their sale? This Court's decision makes the answer doubtful.

Conclusion

Congress set down a great many words in Section 117, presumably after considerable thought and the advice of tax experts, both Government and public. This Court has not said that the meaning of the words as applicable to the instant case are unclear or ambiguous, and indeed they are not. And yet the plain meaning of the words is not followed. As a consequence, the true intention of Congress is overlooked. Its serious concern for the deduction of losses and its desire to limit them is not carried out. So too, this Court's orderly system of statutory construction is not followed. It is not believed that in the long run the Treasury will benefit. Certainly every sale transaction under the new, more or less protean, criteria established or presaged by the decision in the instant case will present infinite uncertainties and concomitant possibilities of litigation. This latter result seems inevitable and most undesirable, and one to which it is not believed this Court, in its consideration of the practicalities involved, could have adverted.

It is respectfully requested that this petition for rehearing be granted.

Dated, November 29, 1955.

Respectfully submitted,

SAMUEL A. MCCAIN
JAY O. KRAMER
Counsel for Petitioner

Certificate of Counsel

We, SAMUEL A. McCAIN and JAY O. KRAMER, counsel for the above named petitioner, do hereby certify that the foregoing Petition for a Rehearing of this cause is presented in good faith and not for delay.

SAMUEL A. McCAIN
JAY O. KRAMER

Dated: New York, New York,
November 29, 1955.

APPENDIX A

RESEARCH INSTITUTE OF AMERICA

1955 EDITION—NF7

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The Supreme Court's decision on hedging transactions has shaken the established concept of capital gains and losses. Here's what happened: The Corn Products Refining Co. used futures contracts in connection with manufacturing products made from grain corn. In order to get an adequate supply of raw corn economically, it would buy futures when the prices appeared favorable. It would take delivery on some contracts and sell others. The company claimed that while hedging transactions gave rise to ordinary income, these dealings were not true hedges and therefore the results should have been capital gains and losses. The Supreme Court held that the gains or losses were ordinary income or loss because (1) the practice of buying futures was an integral part of the taxpayer's business, (2) despite lower court holdings that the taxpayer's activities didn't constitute "true hedging", the transactions were in the nature of a hedge, which is excluded from capital gains treatment, and (3) to allow a capital gain would open a loophole whereby those engaged in hedging operations could convert ordinary income into capital gain.

The Court also had before it the question of whether the "wash sales" provision applies to futures contracts. (This bars a loss on stock or securities if they are repurchased in a 61-day period.) Since the Court decided that ordinary income or loss resulted,

it didn't have to decide whether the wash sales provision applied. (*Corn Products Refining Co. v. Com.*, S. Ct., 11/7/55)

The decision goes far beyond a mere settlement of the hedge situation. It puts the stamp of approval on a *new theory of capital assets* which may create substantial uncertainty in the area of capital gains and losses.

As the tax *statute* reads, there is first a clear, unambiguous statement that "capital assets" means "property held by the taxpayer *(whether or not connected with his trade or business)*". The statute then goes on to say that this "does not include" and lists a series of specific property classes, the most common of which are inventory, property held for sale to customers, and real or depreciable property used in the trade or business. For years, this statutory provision has been interpreted to mean that property is a capital asset (giving capital gain or loss on sale) unless it falls within the statutory exceptions to capital assets.

But the Supreme Court's language seems to end this approach. It said "Admittedly, petitioner's corn futures do not come within the literal language of the exclusions set out in that section. They were not stock in trade . . ." etc. "But the capital asset provision of § 117 must not be so broadly applied as to defeat rather than further the purpose of Congress : . . Congress intended that profits and losses arising from the every-day operation of a business be considered as ordinary income or loss rather than capital gain or loss . . . the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly."

True, this part of the Court's decision was concerned with the fact that "hedges" had long ago been removed from the capital gain and loss area by a Treasury rule which Congress had never overridden in the revenue acts passed since then. But, the *language* is *not* specifically limited to hedges and will certainly be used to reinforce those lower court decisions which have already allowed *ordinary losses* on sale of securities which were acquired for necessary business reasons. It also reinforces a developing tendency on the part of the Tax Court to permit capital gain only in connection with *investments*. The result can be to question such well accepted capital gains as the sale of stock or securities by a trader.

Observation: In following the trend towards limiting the capital gain treatment to investments, the Supreme Court said of the taxpayer's argument: "this is not the talk of the capital investor but of the far-sighted manufacturer". And in discussing the intention of the capital gain section of the law it quoted an earlier Supreme Court case which said that its purpose was "to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments . . ." But note that the statute itself never once uses the word "investment" in defining capital assets.

Observation: In the particular tax year involved, the taxpayer suffered a loss from its futures transactions. But the Court's decision covered gains as well, because the taxpayer realized a gain on its futures transactions in other years involved in the case.

Planning for capital gain tax saving was also hit. The Court offered as a final reason for its conclusion that: "To hold otherwise would permit those engaged

in hedging transactions to transmute ordinary income into capital gain at will. . . . if a sale of the future created a capital transaction while delivery of the commodity under the same future did not, a loophole in the statute would be created and the purpose of Congress frustrated." This kind of approach could raise hob with other established capital gain situations. For example, a stockholder can realize a potential dividend as a capital gain by selling just before the record date which establishes who gets the dividend. If he doesn't sell, the dividend will come in as ordinary income. Is this a loophole to be blocked by a court decision? Or suppose an endowment policyholder sells at a profit before his policy matures. Is this a loophole which the courts can close?

Observation: The *Corn Products* decision is an invitation to litigation and a step toward uncertainty in the important area of capital gains. The Supreme Court's judicial modification of the statutory rules on capital gains and losses can only compound the difficulties of distinguishing between ordinary income and loss and capital gain and loss.